

ASSEMBLY BILL

No. 1644

Introduced by Assembly Member De La Torre

February 22, 2005

An act to amend Section 23802 of, and to repeal Sections 6356.5, 17052.12, 17053.49, 23609, and 23649 of the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 1644, as introduced, De La Torre. Income and corporation tax credits: sales tax exemption: repeals.

The Sales and Use Tax Law imposes a tax on the gross receipts from the sale in this state of, or the storage, use, or other consumption in this state of, tangible personal property. That law provides various exemptions from that tax, including an exemption for farm equipment, and machinery used primarily in producing and harvesting agricultural products.

This bill would repeal that exemption.

The Personal Income Tax Law and the Corporation Tax Law authorize various credits against the taxes imposed by those laws, including a credit for certain research and development expenses.

This bill would repeal those credits. This bill would also delete obsolete provisions relating to manufacturing equipment credits.

The Corporation Tax Law imposes taxes according to or measured by net income at the rate of 8.84%, except, among other things, that the tax is imposed at a rate of 1 and $\frac{1}{2}$ % for Subchapter "S" corporations.

This bill would restrict the tax treatment of Subchapter "S" corporations to those corporations that have annual gross income of less than \$20,000,000.

This bill would result in a change in state taxes for the purpose of increasing state revenues within the meaning of Section 3 of Article XIII A of the California Constitution, and thus would require for passage the approval of $\frac{2}{3}$ of the membership of each house of the Legislature.

This bill would take effect immediately as a tax levy.

Vote: $\frac{2}{3}$. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

1 SECTION 1. Section 6356.5 of the Revenue and Taxation
2 Code is repealed.

3 ~~6356.5. (a) There are exempted from the taxes imposed by~~
4 ~~this part the gross receipts from the sale of, and the storage and~~
5 ~~use of, or other consumption in this state of, farm equipment and~~
6 ~~machinery, and the parts thereof, purchased for use by a qualified~~
7 ~~person to be used primarily in producing and harvesting~~
8 ~~agricultural products.~~

9 ~~(b) For purposes of this section, both of the following shall~~
10 ~~apply:~~

11 ~~(1) "Qualified person" means any person engaged in a line of~~
12 ~~business described in Codes 0111 to 0291, inclusive, of the~~
13 ~~Standard Industrial Classification Manual published by the~~
14 ~~United States Office of Management and Budget, 1987 Edition,~~
15 ~~and any other person that uses farm equipment and machinery to~~
16 ~~assist this person in the lines of business described in this~~
17 ~~paragraph in producing and harvesting agricultural products.~~

18 ~~(2) "Farm equipment and machinery" means implements of~~
19 ~~husbandry, as defined in Section 411.~~

20 ~~(c) (1) Notwithstanding any provision of the Bradley-Burns~~
21 ~~Uniform Local Sales and Use Tax Law (Part 1.5 (commencing~~
22 ~~with Section 7200)) or the Transactions and Use Tax Law (Part~~
23 ~~1.6 (commencing with Section 7251)), the exemption established~~
24 ~~by this section does not apply with respect to any tax levied by a~~
25 ~~county, city, or district pursuant to, or in accordance with, either~~
26 ~~of those laws.~~

27 ~~(2) Notwithstanding subdivision (a), the exemption established~~
28 ~~by this section does not apply with respect to any tax levied~~

1 pursuant to Sections 6051.2 and 6201.2, or pursuant to Section
2 35 of Article XIII of the California Constitution.

3 ~~(d) The exemption provided by this section shall be effective~~
4 ~~starting September 1, 2001, unless the State Board of~~
5 ~~Equalization determines that implementation by that date is not~~
6 ~~feasible, in which case the board shall, on or before that date,~~
7 ~~report to the Legislature regarding the reasons why it must delay~~
8 ~~implementation, and shall thereafter implement the exemption~~
9 ~~provided by this section no later than October 1, 2001.~~

10 SEC. 2. Section 17052.12 of the Revenue and Taxation Code
11 is repealed.

12 ~~17052.12. For each taxable year beginning on or after January~~
13 ~~1, 1987, there shall be allowed as a credit against the "net tax"~~
14 ~~(as defined by Section 17039) for the taxable year an amount~~
15 ~~determined in accordance with Section 41 of the Internal~~
16 ~~Revenue Code, except as follows:~~

17 ~~(a) For each taxable year beginning before January 1, 1997,~~
18 ~~the reference to "20 percent" in Section 41(a)(1) of the Internal~~
19 ~~Revenue Code is modified to read "8 percent."~~

20 ~~(b) (1) For each taxable year beginning on or after January 1,~~
21 ~~1997, and before January 1, 1999, the reference to "20 percent"~~
22 ~~in Section 41(a)(1) of the Internal Revenue Code is modified to~~
23 ~~read "11 percent."~~

24 ~~(2) For each taxable year beginning on or after January 1,~~
25 ~~1999, and before January 1, 2000, the reference to "20 percent"~~
26 ~~in Section 41(a)(1) of the Internal Revenue Code is modified to~~
27 ~~read "12 percent."~~

28 ~~(3) For each taxable year beginning on or after January 1,~~
29 ~~2000, the reference to "20 percent" in Section 41(a)(1) of the~~
30 ~~Internal Revenue Code is modified to read "15 percent."~~

31 ~~(e) Section 41(a)(2) of the Internal Revenue Code, relating to~~
32 ~~basic research payments, shall not apply.~~

33 ~~(d) "Qualified research" shall include only research conducted~~
34 ~~in California.~~

35 ~~(e) In the case where the credit allowed under this section~~
36 ~~exceeds the "net tax," the excess may be carried over to reduce~~
37 ~~the "net tax" in the following year, and succeeding years if~~
38 ~~necessary, until the credit has been exhausted.~~

39 ~~(f) (1) With respect to any expense paid or incurred after the~~
40 ~~operative date of Section 6378, Section 41(b)(1) of the Internal~~

1 Revenue Code is modified to exclude from the definition of
2 “qualified research expense” any amount paid or incurred for
3 tangible personal property that is eligible for the exemption from
4 sales or use tax provided by Section 6378.

5 (2) For each taxable year beginning on or after January 1,
6 1998, the reference to “Section 501(a)” in Section 41(b)(3)(C) of
7 the Internal Revenue Code, relating to contract research
8 expenses, is modified to read “this part or Part 11 (commencing
9 with Section 23001).”

10 (g) (1) For each taxable year beginning on or after January 1,
11 2000:

12 (A) The reference to “2.65 percent” in Section 41(c)(4)(A)(i)
13 of the Internal Revenue Code is modified to read “one and
14 forty-nine hundredths of one percent.”

15 (B) The reference to “3.2 percent” in Section 41(c)(4)(A)(ii) of
16 the Internal Revenue Code is modified to read “one and
17 ninety-eight hundredths of one percent.”

18 (C) The reference to “3.75 percent” in Section 41(c)(4)(A)(iii)
19 of the Internal Revenue Code is modified to read “two and
20 forty-eight hundredths of one percent.”

21 (2) Section 41(c)(4)(B) shall not apply and in lieu thereof an
22 election under Section 41(c)(4)(A) of the Internal Revenue Code
23 may be made for any taxable year of the taxpayer beginning on
24 or after January 1, 1998. That election shall apply to the taxable
25 year for which made and all succeeding taxable years unless
26 revoked with the consent of the Franchise Tax Board.

27 (3) Section 41(c)(6) of the Internal Revenue Code, relating to
28 gross receipts, is modified to take into account only those gross
29 receipts from the sale of property held primarily for sale to
30 customers in the ordinary course of the taxpayer’s trade or
31 business that is delivered or shipped to a purchaser within this
32 state, regardless of f.o.b. point or any other condition of the sale.

33 (h) Section 41(h) of the Internal Revenue Code, relating to
34 termination, shall not apply.

35 (i) Section 41(g) of the Internal Revenue Code, relating to
36 special rule for passthrough of credit, is modified by each of the
37 following:

38 (1) The last sentence shall not apply.

39 (2) If the amount determined under Section 41(a) of the
40 Internal Revenue Code for any taxable year exceeds the

1 ~~limitation of Section 41(g) of the Internal Revenue Code, that~~
2 ~~amount may be carried over to other taxable years under the rules~~
3 ~~of subdivision (c); except that the limitation of Section 41(g) of~~
4 ~~the Internal Revenue Code shall be taken into account in each~~
5 ~~subsequent taxable year.~~

6 SEC. 3. Section 17053.49 of the Revenue and Taxation Code
7 is repealed.

8 ~~17053.49. (a) (1) A qualified taxpayer shall be allowed a~~
9 ~~credit against the “net tax,” as defined in Section 17039, equal to~~
10 ~~6 percent of the qualified cost of qualified property that is placed~~
11 ~~in service in this state.~~

12 ~~(2) In the case of any qualified costs paid or incurred on or~~
13 ~~after January 1, 1994, and prior to the first taxable year of the~~
14 ~~qualified taxpayer beginning on or after January 1, 1995, the~~
15 ~~credit provided under paragraph (1) shall be claimed by the~~
16 ~~qualified taxpayer on the qualified taxpayer’s return for the first~~
17 ~~taxable year beginning on or after January 1, 1995. No credit~~
18 ~~shall be claimed under this section on a return filed for any~~
19 ~~taxable year commencing prior to the qualified taxpayer’s first~~
20 ~~taxable year beginning on or after January 1, 1995.~~

21 ~~(b) (1) For purposes of this section, “qualified cost” means~~
22 ~~any cost that satisfies each of the following conditions:~~

23 ~~(A) Except as otherwise provided in this subparagraph, is a~~
24 ~~cost paid or incurred by the qualified taxpayer for the~~
25 ~~construction, reconstruction, or acquisition of qualified property~~
26 ~~on or after January 1, 1994, and prior to the date this section~~
27 ~~ceases to be operative under paragraph (2) of subdivision (i). In~~
28 ~~the case of any qualified property constructed, reconstructed, or~~
29 ~~acquired by the qualified taxpayer (or any person related to the~~
30 ~~qualified taxpayer within the meaning of Section 267 or 707 of~~
31 ~~the Internal Revenue Code) pursuant to a binding contract in~~
32 ~~existence on or prior to January 1, 1994, costs paid pursuant to~~
33 ~~that contract shall be subject to allocation as follows: contract~~
34 ~~costs shall be allocated to qualified property based on a ratio of~~
35 ~~costs actually paid prior to January 1, 1994, and total contract~~
36 ~~costs actually paid. “Cost paid” shall include, without limitation,~~
37 ~~contractual deposits and option payments. To the extent of costs~~
38 ~~allocated, whether or not currently deductible or depreciable for~~
39 ~~tax purposes, to a period prior to January 1, 1994, the cost shall~~

1 be deemed allocated to property acquired before January 1, 1994,
2 and is thus not a “qualified cost.”

3 (B) Except as provided in paragraph (3) of subdivision (d) and
4 subparagraph (B) of paragraph (4) of subdivision (d), is an
5 amount upon which the qualified taxpayer has paid, directly or
6 indirectly, as a separately stated contract amount or as
7 determined from the records of the qualified taxpayer, sales or
8 use tax under Part 1 (commencing with Section 6001):

9 (C) Is an amount properly chargeable to the capital account of
10 the qualified taxpayer.

11 (2) (A) For purposes of this subdivision, any contract entered
12 into on or after January 1, 1994, that is a successor or
13 replacement contract to a contract that was binding prior to
14 January 1, 1994, shall be treated as a binding contract in
15 existence prior to January 1, 1994.

16 (B) If a successor or replacement contract is entered into on or
17 after January 1, 1994, and the subject of the successor or
18 replacement contract relates both to amounts for the construction,
19 reconstruction, or acquisition of qualified property described in
20 the original binding contract and to costs for the construction,
21 reconstruction, or acquisition of qualified property not described
22 in the original binding contract, then the portion of those amounts
23 described in the successor or replacement contract that were not
24 described in the original binding contract shall not be treated as
25 costs paid or incurred pursuant to a binding contract in existence
26 on or prior to January 1, 1994, under subparagraph (A) of
27 paragraph (1):

28 (3) (A) For purposes of this section, an option contract in
29 existence prior to January 1, 1994, under which a qualified
30 taxpayer (or any other person related to the qualified taxpayer
31 within the meaning of Section 267 or 707 of the Internal Revenue
32 Code) had an option to acquire qualified property, shall be
33 treated as a binding contract under the rules in paragraph (2). For
34 purposes of this subparagraph, an option contract shall not
35 include an option under which the optionholder will forfeit an
36 amount less than 10 percent of the fixed option price in the event
37 the option is not exercised.

38 (B) For purposes of this section, a contract shall be treated as
39 binding even if the contract is subject to a condition.

~~(4) For purposes of this subdivision, in the case of any qualified taxpayer engaged in those lines of business described in Codes 7371 to 7373, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, “the first taxable year beginning on or after January 1, 1998,” shall be substituted for “January 1, 1994,” in each place in which it appears.~~

~~(e) (1) For purposes of this section, “qualified taxpayer” means any taxpayer engaged in those lines of business described in Codes 2011 to 3999, inclusive, or Codes 7371 to 7373, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition.~~

~~(2) In the case of any passthrough entity, the determination of whether a taxpayer is a qualified taxpayer under this section shall be made at the entity level and any credit under this section or Section 23649 shall be allowed to the passthrough entity and passed through to the partners or shareholders in accordance with applicable provisions of Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001). For purposes of this paragraph, the term “passthrough entity” means any partnership or S corporation.~~

~~(3) The Franchise Tax Board may prescribe regulations to carry out the purposes of this section, including any regulations necessary to prevent the avoidance of the effect of this section through splitups, shell corporations, partnerships, tiered ownership structures, sale-leaseback transactions, or otherwise.~~

~~(d) For purposes of this section, “qualified property” means property that is described as any of the following:~~

~~(1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code for use by a qualified taxpayer in those lines of business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, that is primarily used for any of the following:~~

~~(A) For the manufacturing, processing, refining, fabricating, or recycling of property, beginning at the point at which any raw materials are received by the qualified taxpayer and introduced~~

1 into the process and ending at the point at which the
2 manufacturing, processing, refining, fabricating, or recycling has
3 altered tangible personal property to its completed form,
4 including packaging, if required.

5 (B) In research and development.

6 (C) To maintain, repair, measure, or test any property
7 described in this paragraph.

8 (D) For pollution control that meets or exceeds standards
9 established by the state or by any local or regional governmental
10 agency within the state.

11 (E) For recycling.

12 (2) Computers and computer peripheral equipment, as defined
13 in Section 168(i)(2)(B) of the Internal Revenue Code, that is
14 tangible personal property as defined in Section 1245(a) of the
15 Internal Revenue Code for use by a qualified taxpayer in those
16 lines of business described in SIC Codes 7371 to 7373, inclusive,
17 of the SIC Manual, 1987 edition, that is primarily used to
18 develop or manufacture prepackaged software or custom
19 software prepared to the special order of the purchaser who uses
20 the program to produce and sell or license copies of the program
21 as prepackaged software.

22 (3) The value of any capitalized labor costs that are directly
23 allocable to the construction or modification of property
24 described in paragraph (1) or (2).

25 (4) In the case of any qualified taxpayer engaged in
26 manufacturing activities described in SIC Code 357 or 367, those
27 activities related to biotechnology described in SIC Code 8731,
28 those activities related to biopharmaceutical establishments only
29 that are described in SIC Codes 2833 to 2836, inclusive, those
30 activities related to space vehicles and parts described in SIC
31 Codes 3761 to 3769, inclusive, those activities related to space
32 satellites and communications satellites and equipment described
33 in SIC Codes 3663 and 3812 (but only with respect to “qualified
34 property” that is placed in service on or after January 1, 1996), or
35 those activities related to semiconductor equipment
36 manufacturing described in SIC Code 3559 (but only with
37 respect to “qualified property” that is placed in service on or after
38 January 1, 1997), “qualified property” also includes the
39 following:

1 ~~(A) Special purpose buildings and foundations that are~~
2 ~~constructed or modified for use by the qualified taxpayer~~
3 ~~primarily in a manufacturing, processing, refining, or fabricating~~
4 ~~process, or as a research or storage facility primarily used in~~
5 ~~connection with a manufacturing process.~~

6 ~~(B) The value of any capitalized labor costs that are directly~~
7 ~~allocable to the construction or modification of special purpose~~
8 ~~buildings and foundations that are used primarily in the~~
9 ~~manufacturing, processing, refining, or fabricating process, or as~~
10 ~~a research or storage facility primarily used in connection with a~~
11 ~~manufacturing process.~~

12 ~~(C) (i) For purposes of this paragraph, “special purpose~~
13 ~~building and foundation” means only a building and the~~
14 ~~foundation immediately underlying the building that is~~
15 ~~specifically designed and constructed or reconstructed for the~~
16 ~~installation, operation, and use of specific machinery and~~
17 ~~equipment with a special purpose, which machinery and~~
18 ~~equipment, after installation, will become affixed to or a fixture~~
19 ~~of the real property, and the construction or reconstruction of~~
20 ~~which is specifically designed and used exclusively for the~~
21 ~~specified purposes as set forth in subparagraph (A) (“qualified~~
22 ~~purpose”).~~

23 ~~(ii) A building is specifically designed and constructed or~~
24 ~~modified for a qualified purpose if it is not economical to design~~
25 ~~and construct the building for the intended purpose and then use~~
26 ~~the structure for a different purpose.~~

27 ~~(iii) For purposes of clause (i) and clause (vi), a building is~~
28 ~~used exclusively for a qualified purpose only if its use does not~~
29 ~~include a use for which it was not specifically designed and~~
30 ~~constructed or modified. Incidental use of a building for~~
31 ~~nonqualified purposes does not preclude the building from being~~
32 ~~a special purpose building. “Incidental use” means a use which is~~
33 ~~both related and subordinate to the qualified purpose. It will be~~
34 ~~conclusively presumed that a use is not subordinate if more than~~
35 ~~one-third of the total usable volume of the building is devoted to~~
36 ~~a use which is not a qualified purpose.~~

37 ~~(iv) In the event an entire building does not qualify as a special~~
38 ~~purpose building, a taxpayer may establish that a portion of a~~
39 ~~building, and the foundation immediately underlying the portion,~~
40 ~~qualifies for treatment as a special purpose building and~~

1 foundation if the portion satisfies all of the definitional
2 provisions in this subparagraph.

3 (v) To the extent that a building is not a special purpose
4 building as defined above, but a portion of the building qualifies
5 for treatment as a special purpose building, then all equipment
6 which exclusively supports the qualified purpose occurring
7 within that portion and which would qualify as Internal Revenue
8 Code Section 1245 property if it were not a fixture or affixed to
9 the building shall be treated as a cost of the portion of the
10 building which qualifies for treatment as a special purpose
11 building.

12 (vi) Buildings and foundations which do not meet the
13 definition of a special purpose building and foundation set forth
14 above include, but are not limited to: buildings designed and
15 constructed or reconstructed principally to function as a general
16 purpose manufacturing, industrial, or commercial building;
17 research facilities that are used primarily prior to or after, or prior
18 to and after, the manufacturing process; or storage facilities that
19 are used primarily prior to or after, or prior to and after,
20 completion of the manufacturing process. A research facility
21 shall not be considered to be used primarily prior to or after, or
22 prior to and after, the manufacturing process if its purpose and
23 use relate exclusively to the development and regulatory
24 approval of the manufacturing process for specific
25 biopharmaceutical products. A research facility which is used
26 primarily in connection with the discovery of an organism from
27 which a biopharmaceutical product or process is developed does
28 not meet the requirements of the preceding sentence.

29 (5) Subject to the provisions in subparagraph (B) of paragraph
30 (1) of subdivision (b), qualified property also includes computer
31 software that is primarily used for those purposes set forth in
32 paragraph (1) or (2) of this subdivision.

33 (6) Qualified property does not include any of the following:

34 (A) Furniture.

35 (B) Facilities used for warehousing purposes after completion
36 of the manufacturing process.

37 (C) Inventory.

38 (D) Equipment used in the extraction process.

39 (E) Equipment used to store finished products that have
40 completed the manufacturing process.

1 ~~(F) Any tangible personal property that is used in~~
2 ~~administration, general management, or marketing.~~

3 ~~(G) Any vehicle for which a credit is claimed pursuant to~~
4 ~~Section 17052.11 or 23603.~~

5 ~~(e) For purposes of this section:~~

6 ~~(1) "Biopharmaceutical activities" means those activities that~~
7 ~~use organisms or materials derived from organisms, and their~~
8 ~~cellular, subcellular, or molecular components, in order to~~
9 ~~provide pharmaceutical products for human or animal~~
10 ~~therapeutics and diagnostics. Biopharmaceutical activities make~~
11 ~~use of living organisms to make commercial products, as~~
12 ~~opposed to pharmaceutical activities which make use of chemical~~
13 ~~compounds to produce commercial products.~~

14 ~~(2) "Fabricating" means to make, build, create, produce, or~~
15 ~~assemble components or property to work in a new or different~~
16 ~~manner.~~

17 ~~(3) "Manufacturing" means the activity of converting or~~
18 ~~conditioning property by changing the form, composition,~~
19 ~~quality, or character of the property for ultimate sale at retail or~~
20 ~~use in the manufacturing of a product to be ultimately sold at~~
21 ~~retail. Manufacturing includes any improvements to tangible~~
22 ~~personal property that result in a greater service life or greater~~
23 ~~functionality than that of the original property.~~

24 ~~(4) "Other biotechnology activities" means activities~~
25 ~~consisting of the application of recombinant DNA technology to~~
26 ~~produce commercial products, as well as activities regarding~~
27 ~~pharmaceutical delivery systems designed to provide a measure~~
28 ~~of control over the rate, duration, and site of pharmaceutical~~
29 ~~delivery.~~

30 ~~(5) "Primarily" means tangible personal property used 50~~
31 ~~percent or more of the time in an activity described in~~
32 ~~subdivision (d).~~

33 ~~(6) "Process" means the period beginning at the point at which~~
34 ~~any raw materials are received by the qualified taxpayer and~~
35 ~~introduced into the manufacturing, processing, refining,~~
36 ~~fabricating, or recycling activity of the qualified taxpayer and~~
37 ~~ending at the point at which the manufacturing, processing,~~
38 ~~refining, fabricating, or recycling activity of the qualified~~
39 ~~taxpayer has altered tangible personal property to its completed~~
40 ~~form, including packaging, if required. Raw materials shall be~~

1 considered to have been introduced into the process when the
2 raw materials are stored on the same premises where the
3 qualified taxpayer's manufacturing, processing, refining, or
4 recycling activity is conducted. Raw materials that are stored on
5 premises other than where the qualified taxpayer's
6 manufacturing, processing, refining, fabricating, or recycling
7 activity is conducted, shall not be considered to have been
8 introduced into the manufacturing, processing, refining,
9 fabricating, or recycling process.

10 (7) "Processing" means the physical application of the
11 materials and labor necessary to modify or change the
12 characteristics of property.

13 (8) "Refining" means the process of converting a natural
14 resource to an intermediate or finished product.

15 (9) "Research and development" means those activities that
16 are described in Section 174 of the Internal Revenue Code or in
17 any regulations thereunder.

18 (10) "Small business" means a qualified taxpayer that meets
19 any of the following requirements during the taxable year for
20 which the credit is allowed:

21 (A) Has gross receipts of less than fifty million dollars
22 (\$50,000,000).

23 (B) Has net assets of less than fifty million dollars
24 (\$50,000,000).

25 (C) Has a total credit of less than one million dollars
26 (\$1,000,000).

27 (D) For taxable years beginning on or after January 1, 1997, is
28 engaged in biopharmaceutical activities or other biotechnology
29 activities that are described in Codes 2833 to 2836, inclusive, of
30 the Standard Industrial Classification (SIC) Manual published by
31 the United States Office of Management and Budget, 1987
32 edition, and has not received regulatory approval for any product
33 from the United States Food and Drug Administration.

34 (f) The credit allowed under subdivision (a) shall apply to
35 qualified property that is acquired by or subject to lease by a
36 qualified taxpayer, subject to the following special rules:

37 (1) A lessor of qualified property, irrespective of whether the
38 lessor is a qualified taxpayer, shall not be allowed the credit
39 provided under subdivision (a) with respect to any qualified
40 property leased to another qualified taxpayer.

1 ~~(2) For purposes of paragraphs (2) and (3) of subdivision (b),~~
2 ~~“binding contract” shall include any lease agreement with respect~~
3 ~~to the qualified property.~~

4 ~~(3) (A) For purposes of determining the qualified cost paid or~~
5 ~~incurred by a lessee in any leasing transaction that is not treated~~
6 ~~as a sale under Part 1 (commencing with Section 6001), the~~
7 ~~following rules shall apply:~~

8 ~~(i) Except as provided by subparagraph (C) of this paragraph,~~
9 ~~subparagraphs (A) and (C) of paragraph (1) of subdivision (b)~~
10 ~~shall not apply.~~

11 ~~(ii) Except as provided in subparagraph (B) and clause (iii),~~
12 ~~the “qualified cost” upon which the lessee shall compute the~~
13 ~~credit provided under this section shall be equal to the original~~
14 ~~cost to the lessor (within the meaning of Section 18031) of the~~
15 ~~qualified property that is the subject of the lease.~~

16 ~~(iii) Except as provided in clause (iv), the requirement of~~
17 ~~subparagraph (B) of paragraph (1) of subdivision (b) shall be~~
18 ~~treated as satisfied only if the lessor has made a timely election~~
19 ~~under either Section 6094.1 or subdivision (d) of Section 6244~~
20 ~~and has paid sales tax reimbursement or use tax measured by the~~
21 ~~purchase price of the qualified property (within the meaning of~~
22 ~~paragraph (5) of subdivision (g) of Section 6006). For purposes~~
23 ~~of this subdivision and clause (iv), the amount of original cost to~~
24 ~~the lessor which may be taken into account under clause (ii) shall~~
25 ~~not exceed the purchase price upon which sales tax~~
26 ~~reimbursement or use tax has been paid under the preceding~~
27 ~~sentence or under clause (iv).~~

28 ~~(iv) With respect to leases entered into between January 1,~~
29 ~~1994, and the effective date of this clause, the lessor may elect to~~
30 ~~pay use tax measured by the purchase price of the property by~~
31 ~~reporting and paying the tax with the return of the lessor for the~~
32 ~~fourth calendar quarter of 1994. In computing the use tax under~~
33 ~~the preceding sentence, a credit shall be allowed under Part 1~~
34 ~~(commencing with Section 6001) for all sales or use tax~~
35 ~~previously paid on the lease.~~

36 ~~(B) For purposes of applying subparagraph (A) only, the~~
37 ~~following special rules shall apply:~~

38 ~~(i) The original cost to the lessor of the qualified property shall~~
39 ~~be reduced by the amount of any original cost of that property~~

1 that was taken into account by any predecessor lessee in
2 computing the credit allowable under this section.

3 (ii) Clause (i) shall not apply in any case where the
4 predecessor lessee was required to recapture the credit provided
5 under this section pursuant to subdivision (g).

6 (iii) For purposes of this section only, in any case where a
7 successor lessor has acquired qualified property from a
8 predecessor lessor in a transaction not treated as a sale under Part
9 1 (commencing with Section 6001), the original cost to the
10 successor lessor of the qualified property shall be reduced by the
11 amount of the original cost of the qualified property that was
12 taken into account by any lessee of the predecessor lessor in
13 computing the credit allowable under this section.

14 (C) In determining the original cost of any qualified property
15 under this paragraph, only amounts paid or incurred by the lessor
16 on or after January 1, 1994, and prior to the date this section
17 ceases to be operative under paragraph (2) of subdivision (i),
18 shall be taken into account. In the case of any qualified property
19 constructed, reconstructed, or acquired by a lessor pursuant to a
20 binding contract in existence on or prior to January 1, 1994, the
21 allocation rule specified in subparagraph (A) of paragraph (1) of
22 subdivision (b) shall apply in determining the original cost to the
23 lessor of qualified property.

24 (D) Notwithstanding subparagraph (A), in the case of any
25 leasing transaction for which the lessee is allowed the credit
26 under this section and thereafter the lessee (or any party related
27 to the lessee within the meaning of Section 267 or 318 of the
28 Internal Revenue Code) acquires the qualified property from the
29 lessor (or any successor lessor) within one year from the date the
30 qualified property is first used by the lessee under the terms of
31 the lease, the lessee's (or related party's) acquisition of the
32 qualified property from the lessor (or successor lessor) shall be
33 treated as a disposition by the lessee of the qualified property that
34 was subject to the lease under subdivision (g).

35 (4) For purposes of determining the qualified cost paid or
36 incurred by a lessee in any leasing transaction that is treated as a
37 sale under Part 1 (commencing with Section 6001), the following
38 rules shall apply:

1 ~~(A) Subparagraph (A) of paragraph (1) of subdivision (b) shall~~
2 ~~be applied by substituting the term “purchase” for the term~~
3 ~~“construction, reconstruction, or acquisition.”~~

4 ~~(B) Subparagraph (C) of paragraph (1) of subdivision (b) shall~~
5 ~~apply.~~

6 ~~(C) The requirement of subparagraph (B) of paragraph (1) of~~
7 ~~subdivision (b) shall be treated as satisfied at the time that either~~
8 ~~the lessor or the qualified taxpayer pays sales or use tax under~~
9 ~~Part 1 (commencing with Section 6001).~~

10 ~~(5) (A) In the case of any leasing transaction described in~~
11 ~~paragraph (3), the lessor shall provide a statement to the lessee~~
12 ~~specifying the amount of the lessor’s original cost of the~~
13 ~~qualified property and the amount of that cost upon which a sales~~
14 ~~or use tax was paid within 45 days after the close of the lessee’s~~
15 ~~taxable year in which the credit is allowable to the lessee under~~
16 ~~this section.~~

17 ~~(B) The statement required under subparagraph (A) shall be~~
18 ~~made available to the Franchise Tax Board upon request.~~

19 ~~(6) For purposes of this subdivision, in the case of any~~
20 ~~qualified taxpayer engaged in those lines of business described in~~
21 ~~Codes 7371 to 7373, inclusive, of the Standard Industrial~~
22 ~~Classification (SIC) Manual published by the United States~~
23 ~~Office of Management and Budget, 1987 edition, “the first~~
24 ~~taxable year beginning on or after January 1, 1998,” shall be~~
25 ~~substituted for “January 1, 1994,” in each place in which it~~
26 ~~appears. In addition, “the effective date of this paragraph” shall~~
27 ~~be substituted for “the effective date of this clause” and “fourth~~
28 ~~calendar quarter of 1998” shall be substituted for “fourth~~
29 ~~calendar quarter of 1994.”~~

30 ~~(g) No credit shall be allowed if the qualified property is~~
31 ~~removed from the state, is disposed of to an unrelated party, or is~~
32 ~~used for any purpose not qualifying for the credit provided in this~~
33 ~~section in the same taxable year in which the qualified property is~~
34 ~~first placed in service in this state. If any qualified property for~~
35 ~~which a credit is allowed pursuant to this section is thereafter~~
36 ~~removed from this state, disposed of to an unrelated party, or~~
37 ~~used for any purpose not qualifying for the credit provided in this~~
38 ~~section within one year from the date the qualified property is~~
39 ~~first placed in service in this state, the amount of the credit~~
40 ~~allowed by this section for that qualified property shall be~~

1 ~~recaptured by adding that credit amount to the net tax of the~~
2 ~~qualified taxpayer for the taxable year in which the qualified~~
3 ~~property is disposed of, removed, or put to an ineligible use.~~

4 ~~(h) In the case where the credit allowed by this section~~
5 ~~exceeds the “net tax,” the excess may be carried over to reduce~~
6 ~~the “net tax” in the following year, and succeeding years as~~
7 ~~follows:~~

8 ~~(1) Except as provided in paragraph (2), for the seven~~
9 ~~succeeding years if necessary, until the credit is exhausted.~~

10 ~~(2) In the case of a small business, for the nine succeeding~~
11 ~~years, if necessary, until the credit is exhausted.~~

12 ~~(i) (1) This section shall remain in effect until the date~~
13 ~~specified in paragraph (2), on which date this section shall cease~~
14 ~~to be operative, and as of that date is repealed.~~

15 ~~(2) (A) This section shall cease to be operative on January 1,~~
16 ~~2001, or on January 1 of the earliest year thereafter, if the total~~
17 ~~employment in this state, as determined by the Employment~~
18 ~~Development Department on the preceding January 1, does not~~
19 ~~exceed by 100,000 jobs the total employment in this state on~~
20 ~~January 1, 1994. The department shall report to the Legislature~~
21 ~~annually with respect to the determination required by the~~
22 ~~preceding sentence.~~

23 ~~(B) For purposes of this paragraph, “total employment” means~~
24 ~~the total employment in the manufacturing sector, excluding~~
25 ~~employment in the aerospace sector.~~

26 ~~(j) The amendments made by the act adding this subdivision~~
27 ~~shall be operative for taxable years beginning on or after January~~
28 ~~1, 1997, except as provided in paragraph (3) of subdivision (d).~~

29 ~~(k) The amendments made by the act adding this subdivision~~
30 ~~shall be operative for taxable years beginning on or after January~~
31 ~~1, 1998.~~

32 ~~SEC. 4. Section 23609 of the Revenue and Taxation Code is~~
33 ~~repealed.~~

34 ~~23609. For each taxable year beginning on or after January 1,~~
35 ~~1987, there shall be allowed as a credit against the “tax” (as~~
36 ~~defined by Section 23036) an amount determined in accordance~~
37 ~~with Section 41 of the Internal Revenue Code, except as follows:~~

38 ~~(a) For each taxable year beginning before January 1, 1997,~~
39 ~~both of the following modifications shall apply:~~

1 ~~(1) The reference to “20 percent” in Section 41(a)(1) of the~~
2 ~~Internal Revenue Code is modified to read “8 percent.”~~

3 ~~(2) The reference to “20 percent” in Section 41(a)(2) of the~~
4 ~~Internal Revenue Code is modified to read “12 percent.”~~

5 ~~(b) (1) For each taxable year beginning on or after January 1,~~
6 ~~1997, and before January 1, 1999, both of the following~~
7 ~~modifications shall apply:~~

8 ~~(A) The reference to “20 percent” in Section 41(a)(1) of the~~
9 ~~Internal Revenue Code is modified to read “11 percent.”~~

10 ~~(B) The reference to “20 percent” in Section 41(a)(2) of the~~
11 ~~Internal Revenue Code is modified to read “24 percent.”~~

12 ~~(2) For each taxable year beginning on or after January 1,~~
13 ~~1999, and before January 1, 2000, both of the following shall~~
14 ~~apply:~~

15 ~~(A) The reference to “20 percent” in Section 41(a)(1) of the~~
16 ~~Internal Revenue Code is modified to read “12 percent.”~~

17 ~~(B) The reference to “20 percent” in Section 41(a)(2) of the~~
18 ~~Internal Revenue Code is modified to read “24 percent.”~~

19 ~~(3) For each taxable year beginning on or after January 1,~~
20 ~~2000, both of the following shall apply:~~

21 ~~(A) The reference to “20 percent” in Section 41(a)(1) of the~~
22 ~~Internal Revenue Code is modified to read “15 percent.”~~

23 ~~(B) The reference to “20 percent” in Section 41(a)(2) of the~~
24 ~~Internal Revenue Code is modified to read “24 percent.”~~

25 ~~(c) (1) With respect to any expense paid or incurred after the~~
26 ~~operative date of Section 6378, Section 41(b)(1) of the Internal~~
27 ~~Revenue Code is modified to exclude from the definition of~~
28 ~~“qualified research expense” any amount paid or incurred for~~
29 ~~tangible personal property that is eligible for the exemption from~~
30 ~~sales or use tax provided by Section 6378.~~

31 ~~(2) “Qualified research” and “basic research” shall include~~
32 ~~only research conducted in California.~~

33 ~~(d) The provisions of Section 41(c)(7)(A) of the Internal~~
34 ~~Revenue Code, shall be modified so that “basic research,” for~~
35 ~~purposes of this section, includes any basic or applied research~~
36 ~~including scientific inquiry or original investigation for the~~
37 ~~advancement of scientific or engineering knowledge or the~~
38 ~~improved effectiveness of commercial products, except that the~~
39 ~~term does not include any of the following:~~

40 ~~(1) Basic research conducted outside California.~~

~~(2) Basic research in the social sciences, arts, or humanities.~~

~~(3) Basic research for the purpose of improving a commercial product if the improvements relate to style, taste, cosmetic, or seasonal design factors.~~

~~(4) Any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas).~~

~~(e) (1) In the case of a taxpayer engaged in any biopharmaceutical research activities that are described in codes 2833 to 2836, inclusive, or any research activities that are described in codes 3826, 3829, or 3841 to 3845, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, or any other biotechnology research and development activities, the provisions of Section 41(e)(6) of the Internal Revenue Code shall be modified to include both of the following:~~

~~(A) A qualified organization as described in Section 170(b)(1)(A)(iii) of the Internal Revenue Code and owned by an institution of higher education as described in Section 3304(f) of the Internal Revenue Code.~~

~~(B) A charitable research hospital owned by an organization that is described in Section 501(c)(3) of the Internal Revenue Code, is exempt from taxation under Section 501(a) of the Internal Revenue Code, is not a private foundation, is designated a “specialized laboratory cancer center,” and has received Clinical Cancer Research Center status from the National Cancer Institute.~~

~~(2) For purposes of this subdivision:~~

~~(A) “Biopharmaceutical research activities” means those activities that use organisms or materials derived from organisms, and their cellular, subcellular, or molecular components, in order to provide pharmaceutical products for human or animal therapeutics and diagnostics. Biopharmaceutical activities make use of living organisms to make commercial products, as opposed to pharmaceutical activities that make use of chemical compounds to produce commercial products.~~

~~(B) “Other biotechnology research and development activities” means research and development activities consisting of the application of recombinant DNA technology to produce~~

1 commercial products, as well as research and development
2 activities regarding pharmaceutical delivery systems designed to
3 provide a measure of control over the rate, duration, and site of
4 pharmaceutical delivery.

5 (f) In the case where the credit allowed by this section exceeds
6 the “tax,” the excess may be carried over to reduce the “tax” in
7 the following year, and succeeding years if necessary, until the
8 credit has been exhausted.

9 (g) For each taxable year beginning on or after January 1,
10 1998, the reference to “Section 501(a)” in Section 41(b)(3)(C) of
11 the Internal Revenue Code, relating to contract research
12 expenses, is modified to read “this part or Part 10 (commencing
13 with Section 17001).”

14 (h) (1) For each taxable year beginning on or after January 1,
15 2000:

16 (A) The reference to “2.65 percent” in Section 41(e)(4)(A)(i)
17 of the Internal Revenue Code is modified to read “one and
18 forty-nine hundredths of one percent.”

19 (B) The reference to “3.2 percent” in Section 41(e)(4)(A)(ii) of
20 the Internal Revenue Code is modified to read “one and
21 ninety-eight hundredths of one percent.”

22 (C) The reference to “3.75 percent” in Section 41(e)(4)(A)(iii)
23 of the Internal Revenue Code is modified to read “two and
24 forty-eight hundredths of one percent.”

25 (2) Section 41(e)(4)(B) shall not apply and in lieu thereof an
26 election under Section 41(e)(4)(A) of the Internal Revenue Code
27 may be made for any taxable year of the taxpayer beginning on
28 or after January 1, 1998. That election shall apply to the taxable
29 year for which made and all succeeding taxable years unless
30 revoked with the consent of the Franchise Tax Board.

31 (3) Section 41(e)(6) of the Internal Revenue Code, relating to
32 gross receipts, is modified to take into account only those gross
33 receipts from the sale of property held primarily for sale to
34 customers in the ordinary course of the taxpayer’s trade or
35 business that is delivered or shipped to a purchaser within this
36 state, regardless of f.o.b. point or any other condition of the sale.

37 (i) Section 41(h) of the Internal Revenue Code, relating to
38 termination, shall not apply.

~~(j) Section 41(g) of the Internal Revenue Code, relating to special rule for passthrough of credit, is modified by each of the following:~~

~~(1) The last sentence shall not apply.~~

~~(2) If the amount determined under Section 41(a) of the Internal Revenue Code for any taxable year exceeds the limitation of Section 41(g) of the Internal Revenue Code, that amount may be carried over to other taxable years under the rules of subdivision (f), except that the limitation of Section 41(g) of the Internal Revenue Code shall be taken into account in each subsequent taxable year.~~

SEC. 5. Section 23649 of the Revenue and Taxation Code is repealed.

~~23649. (a) (1) A qualified taxpayer shall be allowed a credit against the "tax," as defined in Section 23036, equal to 6 percent of the qualified cost of qualified property that is placed in service in this state.~~

~~(2) In the case of any qualified costs paid or incurred on or after January 1, 1994, and prior to the first taxable year of the qualified taxpayer beginning on or after January 1, 1995, the credit provided under paragraph (1) shall be claimed by the qualified taxpayer on the qualified taxpayer's return for the first taxable year beginning on or after January 1, 1995. No credit shall be claimed under this section on a return filed for any taxable year commencing prior to the qualified taxpayer's first taxable year beginning on or after January 1, 1995.~~

~~(b) (1) For purposes of this section, "qualified cost" means any cost that satisfies each of the following conditions:~~

~~(A) Except as otherwise provided in this subparagraph, is a cost paid or incurred by the qualified taxpayer for the construction, reconstruction, or acquisition of qualified property on or after January 1, 1994, and prior to the date this section ceases to be operative under paragraph (2) of subdivision (i). In the case of any qualified property constructed, reconstructed, or acquired by the qualified taxpayer (or any person related to the qualified taxpayer within the meaning of Section 267 or 707 of the Internal Revenue Code) pursuant to a binding contract in existence on or prior to January 1, 1994, costs paid pursuant to that contract shall be subject to allocation as follows: contract costs shall be allocated to qualified property based on a ratio of~~

1 costs actually paid prior to January 1, 1994, and total contract
2 costs actually paid. "Cost paid" shall include, without limitation,
3 contractual deposits and option payments. To the extent of cost
4 allocated, whether or not currently deductible or depreciable for
5 tax purposes, to a period prior to January 1, 1994, the cost shall
6 be deemed allocated to property acquired before January 1, 1994,
7 and is thus not a "qualified cost."

8 (B) Except as provided in paragraph (3) of subdivision (d) and
9 subparagraph (B) of paragraph (4) of subdivision (d), is an
10 amount upon which the qualified taxpayer has paid, directly or
11 indirectly as a separately stated contract amount or as determined
12 from the records of the qualified taxpayer, sales or use tax under
13 Part 1 (commencing with Section 6001).

14 (C) Is an amount properly chargeable to the capital account of
15 the qualified taxpayer.

16 (2) (A) For purposes of this subdivision, any contract entered
17 into on or after January 1, 1994, that is a successor or
18 replacement contract to a contract that was binding prior to
19 January 1, 1994, shall be treated as a binding contract in
20 existence prior to January 1, 1994.

21 (B) If a successor or replacement contract is entered into on or
22 after January 1, 1994, and the subject of the successor or
23 replacement contract relates both to amounts for the construction,
24 reconstruction, or acquisition of qualified property described in
25 the original binding contract and to costs for the construction,
26 reconstruction, or acquisition of qualified property not described
27 in the original binding contract, then the portion of those amounts
28 described in the successor or replacement contract that were not
29 described in the original binding contract shall not be treated as
30 costs paid or incurred pursuant to a binding contract in existence
31 on or prior to January 1, 1994, under subparagraph (A) of
32 paragraph (1).

33 (3) (A) For purposes of this section, an option contract in
34 existence prior to January 1, 1994, under which a qualified
35 taxpayer (or any other person related to the qualified taxpayer
36 within the meaning of Section 267 or 707 of the Internal Revenue
37 Code) had an option to acquire qualified property, shall be
38 treated as a binding contract under the rules in paragraph (2). For
39 purposes of this subparagraph, an option contract shall not
40 include an option under which the optionholder will forfeit an

1 amount less than 10 percent of the fixed option price in the event
2 the option is not exercised.

3 (B) For purposes of this section, a contract shall be treated as
4 binding even if the contract is subject to a condition.

5 (4) For purposes of this subdivision, in the case of any
6 qualified taxpayer engaged in those lines of business described in
7 Codes 7371 to 7373, inclusive, of the Standard Industrial
8 Classification (SIC) Manual published by the United States
9 Office of Management and Budget, 1987 edition, “the first
10 taxable year beginning on or after January 1, 1998,” shall be
11 substituted for “January 1, 1994,” in each place in which it
12 appears.

13 (e) (1) For purposes of this section, “qualified taxpayer”
14 means any taxpayer engaged in those lines of business described
15 in Codes 2011 to 3999, inclusive, or Codes 7371 to 7373,
16 inclusive, of the Standard Industrial Classification (SIC) Manual
17 published by the United States Office of Management and
18 Budget, 1987 edition.

19 (2) In the case of any passthrough entity, the determination of
20 whether a taxpayer is a qualified taxpayer shall be made at the
21 entity level and any credit under this section or Section 17053.49
22 shall be allowed to the passthrough entity and passed through to
23 the partners or shareholders in accordance with applicable
24 provisions of Part 10 (commencing with Section 17001) or Part
25 11 (commencing with Section 23001). For purposes of this
26 paragraph, the term “passthrough entity” means any partnership
27 or S corporation.

28 (3) The Franchise Tax Board may prescribe regulations to
29 carry out the purposes of this section, including any regulations
30 necessary to prevent the avoidance of the effect of this section
31 through splitups, shell corporations, partnerships, tiered
32 ownership structures, sale-leaseback transactions, or otherwise.

33 (d) For purposes of this section, “qualified property” means
34 property that is described as either of the following:

35 (1) Tangible personal property that is defined in Section
36 1245(a) of the Internal Revenue Code for use by a qualified
37 taxpayer in those lines of business described in Codes 2011 to
38 3999, inclusive, of the Standard Industrial Classification (SIC)
39 Manual published by the United States Office of Management

1 and Budget, 1987 edition, that is primarily used for any of the
2 following:

3 (A) For the manufacturing, processing, refining, fabricating, or
4 recycling of property, beginning at the point at which any raw
5 materials are received by the qualified taxpayer and introduced
6 into the process and ending at the point at which the
7 manufacturing, processing, refining, fabricating, or recycling has
8 altered tangible personal property to its completed form,
9 including packaging, if required.

10 (B) In research and development.

11 (C) To maintain, repair, measure, or test any property
12 described in this paragraph.

13 (D) For pollution control that meets or exceeds standards
14 established by the state or by any local or regional governmental
15 agency within the state.

16 (E) For recycling.

17 (2) Computers and computer peripheral equipment, as defined
18 in Section 168(i)(2)(B) of the Internal Revenue Code, that is
19 tangible personal property as defined in Section 1245(a) of the
20 Internal Revenue Code for use by a qualified taxpayer in those
21 lines of business described in SIC Codes 7371 to 7373, inclusive,
22 of the SIC Manual, 1987 edition, that is primarily used to
23 develop or manufacture prepackaged software or custom
24 software prepared to the special order of the purchaser who uses
25 the program to produce and sell or license copies of the program
26 as prepackaged software.

27 (3) The value of any capitalized labor costs that are directly
28 allocable to the construction or modification of property
29 described in paragraph (1) or (2).

30 (4) In the case of any qualified taxpayer engaged in
31 manufacturing activities described in SIC Code 357 or 367, those
32 activities related to biotechnology described in SIC Code 8731,
33 those activities related to biopharmaceutical establishments only
34 that are described in SIC Codes 2833 to 2836, inclusive, those
35 activities related to space vehicles and parts described in SIC
36 Codes 3761 to 3769, inclusive, those activities related to space
37 satellites and communications satellites and equipment described
38 in SIC Codes 3663 and 3812 (but only with respect to “qualified
39 property” that is placed in service on or after January 1, 1996), or
40 those activities related to semiconductor equipment

1 manufacturing described in SIC Code 3559 (but only with
2 respect to “qualified property” that is placed in service on or after
3 January 1, 1997), “qualified property” also includes the
4 following:

5 (A) Special purpose buildings and foundations that are
6 constructed or modified for use by the qualified taxpayer
7 primarily in a manufacturing, processing, refining, or fabricating
8 process, or as a research or storage facility primarily used in
9 connection with a manufacturing process.

10 (B) The value of any capitalized labor costs that are directly
11 allocable to the construction or modification of special purpose
12 buildings and foundations that are used primarily in the
13 manufacturing, processing, refining, or fabricating process, or as
14 a research or storage facility primarily used in connection with a
15 manufacturing process.

16 (C) (i) For purposes of this paragraph, “special purpose
17 building and foundation” means only a building and the
18 foundation immediately underlying the building that is
19 specifically designed and constructed or reconstructed for the
20 installation, operation, and use of specific machinery and
21 equipment with a special purpose, which machinery and
22 equipment, after installation, will become affixed to or a fixture
23 of the real property, and the construction or reconstruction of
24 which is specifically designed and used exclusively for the
25 specified purposes as set forth in subparagraph (A) (“qualified
26 purpose”).

27 (ii) A building is specifically designed and constructed or
28 modified for a qualified purpose if it is not economical to design
29 and construct the building for the intended purpose and then use
30 the structure for a different purpose.

31 (iii) For purposes of clause (i) and clause (vi), a building is
32 used exclusively for a qualified purpose only if its use does not
33 include a use for which it was not specifically designed and
34 constructed or modified. Incidental use of a building for
35 nonqualified purposes does not preclude the building from being
36 a special purpose building. “Incidental use” means a use which is
37 both related and subordinate to the qualified purpose. It will be
38 conclusively presumed that a use is not subordinate if more than
39 one-third of the total usable volume of the building is devoted to
40 a use which is not a qualified purpose.

1 ~~(iv) In the event an entire building does not qualify as a special~~
2 ~~purpose building, a taxpayer may establish that a portion of a~~
3 ~~building, and the foundation immediately underlying the portion,~~
4 ~~qualifies for treatment as a special purpose building and~~
5 ~~foundation if the portion satisfies all of the definitional~~
6 ~~provisions in this subparagraph.~~

7 ~~(v) To the extent that a building is not a special purpose~~
8 ~~building as defined above, but a portion of the building qualifies~~
9 ~~for treatment as a special purpose building, then all equipment~~
10 ~~which exclusively supports the qualified purpose occurring~~
11 ~~within that portion and which would qualify as Internal Revenue~~
12 ~~Code Section 1245 property if it were not a fixture or affixed to~~
13 ~~the building shall be treated as a cost of the portion of the~~
14 ~~building which qualifies for treatment as a special purpose~~
15 ~~building.~~

16 ~~(vi) Buildings and foundations which do not meet the~~
17 ~~definition of a special purpose building and foundation set forth~~
18 ~~above include, but are not limited to: buildings designed and~~
19 ~~constructed or reconstructed principally to function as a general~~
20 ~~purpose manufacturing, industrial, or commercial building;~~
21 ~~research facilities that are used primarily prior to or after, or prior~~
22 ~~to and after, the manufacturing process; or storage facilities that~~
23 ~~are used primarily prior to or after, or prior to and after,~~
24 ~~completion of the manufacturing process. A research facility~~
25 ~~shall not be considered to be used primarily prior to or after, or~~
26 ~~prior to and after, the manufacturing process if its purpose and~~
27 ~~use relate exclusively to the development and regulatory~~
28 ~~approval of the manufacturing process for specific~~
29 ~~biopharmaceutical products. A research facility which is used~~
30 ~~primarily in connection with the discovery of an organism from~~
31 ~~which a biopharmaceutical product or process is developed does~~
32 ~~not meet the requirements of the preceding sentence.~~

33 ~~(5) Subject to the provisions in subparagraph (B) of paragraph~~
34 ~~(1) of subdivision (b), qualified property also includes computer~~
35 ~~software that is primarily used for those purposes set forth in~~
36 ~~paragraph (1) or (2) of this subdivision.~~

37 ~~(6) Qualified property does not include any of the following:~~

38 ~~(A) Furniture.~~

39 ~~(B) Facilities used for warehousing purposes after completion~~
40 ~~of the manufacturing process.~~

1 ~~(C) Inventory.~~

2 ~~(D) Equipment used in the extraction process.~~

3 ~~(E) Equipment used to store finished products that have~~
4 ~~completed the manufacturing process.~~

5 ~~(F) Any tangible personal property that is used in~~
6 ~~administration, general management, or marketing.~~

7 ~~(G) Any vehicle for which a credit is claimed pursuant to~~
8 ~~Section 17052.11 or 23603.~~

9 ~~(e) For purposes of this section:~~

10 ~~(1) "Biopharmaceutical activities" means those activities that~~
11 ~~use organisms or materials derived from organisms, and their~~
12 ~~cellular, subcellular, or molecular components, in order to~~
13 ~~provide pharmaceutical products for human or animal~~
14 ~~therapeutics and diagnostics. Biopharmaceutical activities make~~
15 ~~use of living organisms to make commercial products, as~~
16 ~~opposed to pharmaceutical activities which make use of chemical~~
17 ~~compounds to produce commercial products.~~

18 ~~(2) "Fabricating" means to make, build, create, produce, or~~
19 ~~assemble components or property to work in a new or different~~
20 ~~manner.~~

21 ~~(3) "Manufacturing" means the activity of converting or~~
22 ~~conditioning property by changing the form, composition,~~
23 ~~quality, or character of the property for ultimate sale at retail or~~
24 ~~use in the manufacturing of a product to be ultimately sold at~~
25 ~~retail. Manufacturing includes any improvements to tangible~~
26 ~~personal property that result in a greater service life or greater~~
27 ~~functionality than that of the original property.~~

28 ~~(4) "Other biotechnology activities" means activities~~
29 ~~consisting of the application of recombinant DNA technology to~~
30 ~~produce commercial products, as well as activities regarding~~
31 ~~pharmaceutical delivery systems designed to provide a measure~~
32 ~~of control over the rate, duration, and site of pharmaceutical~~
33 ~~delivery.~~

34 ~~(5) "Primarily" means tangible personal property used 50~~
35 ~~percent or more of the time in an activity described in~~
36 ~~subdivision (d).~~

37 ~~(6) "Process" means the period beginning at the point at which~~
38 ~~any raw materials are received by the qualified taxpayer and~~
39 ~~introduced into the manufacturing, processing, refining,~~
40 ~~fabricating, or recycling activity of the qualified person and~~

1 ending at the point at which the manufacturing, processing,
2 refining, fabricating, or recycling activity of the qualified
3 taxpayer has altered tangible personal property to its completed
4 form, including packaging, if required. Raw materials shall be
5 considered to have been introduced into the process when the
6 raw materials are stored on the same premises where the
7 qualified taxpayer's manufacturing, processing, refining,
8 fabricating, or recycling activity is conducted. Raw materials that
9 are stored on premises other than where the qualified taxpayer's
10 manufacturing, processing, refining, fabricating, or recycling
11 activity is conducted, shall not be considered to have been
12 introduced into the manufacturing, processing, refining,
13 fabricating, or recycling process.

14 (7) "Processing" means the physical application of the
15 materials and labor necessary to modify or change the
16 characteristics of property.

17 (8) "Refining" means the process of converting a natural
18 resource to an intermediate or finished product.

19 (9) "Research and development" means those activities that
20 are described in Section 174 of the Internal Revenue Code or in
21 any regulations thereunder.

22 (10) "Small business" means a qualified taxpayer that meets
23 any of the following requirements during the taxable year for
24 which the credit is allowed:

25 (A) Has gross receipts of less than fifty million dollars
26 (\$50,000,000).

27 (B) Has net assets of less than fifty million dollars
28 (\$50,000,000).

29 (C) Has a total credit of less than one million dollars
30 (\$1,000,000).

31 (D) For taxable years beginning on or after January 1, 1997, is
32 engaged in biopharmaceutical activities or other biotechnology
33 activities that are described in Codes 2833 to 2836, inclusive, of
34 the Standard Industrial Classification (SIC) Manual published by
35 the United States Office of Management and Budget, 1987
36 edition, and has not received regulatory approval for any product
37 from the United States Food and Drug Administration.

38 (f) The credit allowed under subdivision (a) shall apply to
39 qualified property that is acquired by or subject to lease by a
40 qualified taxpayer, subject to the following special rules:

1 ~~(1) A lessor of qualified property, irrespective of whether the~~
2 ~~lessor is a qualified taxpayer, shall not be allowed the credit~~
3 ~~provided under subdivision (a) with respect to any qualified~~
4 ~~property leased to another qualified taxpayer.~~

5 ~~(2) For purposes of paragraphs (2) and (3) of subdivision (b),~~
6 ~~“binding contract” shall include any lease agreement with respect~~
7 ~~to the qualified property.~~

8 ~~(3) (A) For purposes of determining the qualified cost paid or~~
9 ~~incurred by a lessee in any leasing transaction that is not treated~~
10 ~~as a sale under Part 1 (commencing with Section 6001), the~~
11 ~~following rules shall apply:~~

12 ~~(i) Except as provided by subparagraph (C) of this paragraph,~~
13 ~~subparagraphs (A) and (C) of paragraph (1) of subdivision (b)~~
14 ~~shall not apply.~~

15 ~~(ii) Except as provided in subparagraph (B) and clause (iii),~~
16 ~~the “qualified cost” upon which the lessee shall compute the~~
17 ~~credit provided under this section shall be equal to the original~~
18 ~~cost to the lessor (within the meaning of Section 24912) of the~~
19 ~~qualified property that is the subject of the lease.~~

20 ~~(iii) Except as provided in clause (iv), the requirement of~~
21 ~~subparagraph (B) of paragraph (1) of subdivision (b) shall be~~
22 ~~treated as satisfied only if the lessor has made a timely election~~
23 ~~under either Section 6094.1 or subdivision (d) of Section 6244~~
24 ~~and has paid sales tax reimbursement or use tax measured by the~~
25 ~~purchase price of the qualified property (within the meaning of~~
26 ~~paragraph (5) of subdivision (g) of Section 6006). For purposes~~
27 ~~of this subdivision and clause (iv), the amount of original cost to~~
28 ~~the lessor which may be taken into account under clause (ii) shall~~
29 ~~not exceed the purchase price upon which sales tax~~
30 ~~reimbursement or use tax has been paid under the preceding~~
31 ~~sentence or under clause (iv).~~

32 ~~(iv) With respect to leases entered into between January 1,~~
33 ~~1994, and the effective date of this clause, the lessor may elect to~~
34 ~~pay use tax measured by the purchase price of the property by~~
35 ~~reporting and paying the tax with the return of the lessor for the~~
36 ~~fourth calendar quarter of 1994. In computing the use tax under~~
37 ~~the preceding sentence, a credit shall be allowed under Part 1~~
38 ~~(commencing with Section 6001) for all sales or use tax~~
39 ~~previously paid on the lease.~~

1 ~~(B) For purposes of applying subparagraph (A) only, the~~
2 ~~following special rules shall apply:~~

3 ~~(i) The original cost to the lessor of the qualified property shall~~
4 ~~be reduced by the amount of any original cost of that property~~
5 ~~that was taken into account by any predecessor lessee in~~
6 ~~computing the credit allowable under this section.~~

7 ~~(ii) Clause (i) shall not apply in any case where the~~
8 ~~predecessor lessee was required to recapture the credit provided~~
9 ~~under this section pursuant to subdivision (g).~~

10 ~~(iii) For purposes of this section only, in any case where a~~
11 ~~successor lessor has acquired qualified property from a~~
12 ~~predecessor lessor in a transaction not treated as a sale under Part~~
13 ~~1 (commencing with Section 6001), the original cost to the~~
14 ~~successor lessor of the qualified property shall be reduced by the~~
15 ~~amount of the original cost of the qualified property that was~~
16 ~~taken into account by any lessee of the predecessor lessor in~~
17 ~~computing the credit allowable under this section.~~

18 ~~(C) In determining the original cost of any qualified property~~
19 ~~under this paragraph, only amounts paid or incurred by the lessor~~
20 ~~on or after January 1, 1994, and prior to the date this section~~
21 ~~ceases to be operative under paragraph (2) of subdivision (i),~~
22 ~~shall be taken into account. In the case of any qualified property~~
23 ~~constructed, reconstructed, or acquired by a lessor pursuant to a~~
24 ~~binding contract in existence on or prior to January 1, 1994, the~~
25 ~~allocation rule specified in subparagraph (A) of paragraph (1) of~~
26 ~~subdivision (b) shall apply in determining the original cost to the~~
27 ~~lessor of qualified property.~~

28 ~~(D) Notwithstanding subparagraph (A), in the case of any~~
29 ~~leasing transaction for which the lessee is allowed the credit~~
30 ~~under this section and thereafter the lessee (or any party related~~
31 ~~to the lessee within the meaning of Section 267 or 318 of the~~
32 ~~Internal Revenue Code) acquires the qualified property from the~~
33 ~~lessor (or any successor lessor) within one year from the date the~~
34 ~~qualified property is first used by the lessee under the terms of~~
35 ~~the lease, the lessee's (or related party's) acquisition of the~~
36 ~~qualified property from the lessor (or successor lessor) shall be~~
37 ~~treated as a disposition by the lessee of the qualified property that~~
38 ~~was subject to the lease under subdivision (g).~~

39 ~~(4) For purposes of determining the qualified cost paid or~~
40 ~~incurred by a lessee in any leasing transaction that is treated as a~~

1 sale under Part 1 (commencing with Section 6001), the following
2 rules shall apply:

3 (A) Subparagraph (A) of paragraph (1) of subdivision (b) shall
4 be applied by substituting the term “purchase” for the term
5 “construction, reconstruction, or acquisition.”

6 (B) Subparagraph (C) of paragraph (1) of subdivision (b) shall
7 apply.

8 (C) The requirement of subparagraph (B) of paragraph (1) of
9 subdivision (b) shall be treated as satisfied at the time that either
10 the lessor or the qualified taxpayer pays sales or use tax under
11 Part 1 (commencing with Section 6001).

12 (5) (A) In the case of any leasing transaction described in
13 paragraph (3), the lessor shall provide a statement to the lessee
14 specifying the amount of the lessor’s original cost of the
15 qualified property and the amount of that cost upon which a sales
16 or use tax was paid within 45 days after the close of the lessee’s
17 taxable year in which the credit is allowable to the lessee under
18 this section.

19 (B) The statement required under subparagraph (A) shall be
20 made available to the Franchise Tax Board upon request.

21 (6) For purposes of this subdivision, in the case of any
22 qualified taxpayer engaged in those lines of business described in
23 Codes 7371 to 7373, inclusive, of the Standard Industrial
24 Classification (SIC) Manual published by the United States
25 Office of Management and Budget, 1987 edition, “the first
26 taxable year beginning on or after January 1, 1998,” shall be
27 substituted for “January 1, 1994,” in each place in which it
28 appears. In addition, “the effective date of this paragraph” shall
29 be substituted for “the effective date of this clause” and “fourth
30 calendar quarter of 1998” shall be substituted for “fourth
31 calendar quarter of 1994.”

32 (g) No credit shall be allowed if the qualified property is
33 removed from the state, is disposed of to an unrelated party, or is
34 used for any purpose not qualifying for the credit provided in this
35 section in the same taxable year in which the qualified property is
36 first placed in service in this state. If any qualified property for
37 which a credit is allowed pursuant to this section is thereafter
38 removed from this state, disposed of to an unrelated party, or
39 used for any purpose not qualifying for the credit provided in this
40 section within one year from the date the qualified property is

1 first placed in service in this state, the amount of the credit
2 allowed by this section for that qualified property shall be
3 recaptured by adding that credit amount to the net tax of the
4 qualified taxpayer for the taxable year in which the qualified
5 property is disposed of, removed, or put to an ineligible use. The
6 sale of stock for which an election was made or deemed to have
7 been made pursuant to Section 338(g) or 338(h)(10) of the
8 Internal Revenue Code may not be treated as a disposition of
9 qualified property to an unrelated party for purposes of this
10 subdivision.

11 (h) In the case where the credit allowed by this section
12 exceeds the "tax," the excess may be carried over to reduce the
13 "tax" in the following year, and succeeding years as follows:

14 (1) Except as provided in paragraph (2), for the seven
15 succeeding years if necessary, until the credit is exhausted.

16 (2) In the case of a small business, for the nine succeeding
17 years, if necessary, until the credit is exhausted.

18 (i) (1) This section shall remain in effect until the date
19 specified in paragraph (2) on which date this section shall cease
20 to be operative, and as of that date is repealed.

21 (2) (A) This section shall cease to be operative on January 1,
22 2001, or on January 1 of the earliest year thereafter, if the total
23 employment in this state, as determined by the Employment
24 Development Department on the preceding January 1, does not
25 exceed by 100,000 jobs the total employment in this state on
26 January 1, 1994. The department shall report to the Legislature
27 annually with respect to the determination required by the
28 preceding sentence.

29 (B) For purposes of this paragraph, "total employment" means
30 the total employment in the manufacturing sector, excluding
31 employment in the aerospace sector.

32 (j) The amendments made by the act adding this subdivision
33 shall be operative for taxable years beginning on or after January
34 1, 1997, except as provided in paragraph (3) of subdivision (d).

35 (k) The amendments made by the act adding this subdivision
36 shall be operative for taxable years beginning on or after January
37 1, 1998.

38 SEC. 6. Section 23802 of the Revenue and Taxation Code is
39 amended to read:

1 23802. (a) Section 1363(a) of the Internal Revenue Code,
2 relating to the taxability of an “S” corporation does not apply.

3 (b) Corporations that are “S” corporations under this chapter
4 shall continue to be subject to the taxes imposed under Chapter 2
5 (commencing with Section 23101) and Chapter 3 (commencing
6 with Section 23501), except as follows:

7 (1) The tax imposed under Section 23151 or 23501 shall be
8 imposed at a rate of 1 ½ percent rather than the rate specified in
9 those sections, *but only with respect to "S" corporations with*
10 *gross income of less than twenty million dollars (\$20,000,000)*
11 *for the taxable year.*

12 (2) In the case of an “S” corporation that is also a financial
13 corporation, the rate of tax specified in paragraph (1) shall be
14 increased by the excess of the rate imposed under Section 23183
15 over the rate imposed under Section 23151.

16 (c) An “S” corporation shall be subject to the minimum
17 franchise tax imposed under Section 23153.

18 (d) (1) For purposes of subdivision (b), an “S” corporation
19 shall be allowed a deduction under Section 24416 or 24416.1
20 (relating to net operating loss deductions), but only with respect
21 to losses incurred during periods in which the corporation is an
22 “S” corporation for purposes of this part.

23 (2) Section 1371(b) of the Internal Revenue Code, relating to
24 denial of carryovers between “C” years and “S” years, shall
25 apply for purposes of the tax imposed under subdivision (b),
26 except as provided in paragraph (1).

27 (3) The provisions of this subdivision do not affect the amount
28 of any item of income or loss computed in accordance with the
29 provisions of Section 1366 of the Internal Revenue Code,
30 relating to pass-thru of items to shareholders.

31 (4) For purposes of subdivision (b) of Section 17276, relating
32 to limitations on loss carryovers, losses passed through to
33 shareholders of an “S” corporation, to the extent otherwise
34 allowable without application of that subdivision, shall be fully
35 included in the net operating loss of that shareholder and then
36 that subdivision shall be applied to the entire net operating loss.

37 (e) For purposes of computing the taxes specified in
38 subdivision (b), an “S” corporation shall be allowed a deduction
39 from income for built-in gains and passive investment income for
40 which a tax has been imposed under this part in accordance with

1 the provisions of Section 1374 of the Internal Revenue Code,
2 relating to tax imposed on certain built-in gains, or Section 1375
3 of the Internal Revenue Code, relating to tax imposed on passive
4 investment income.

5 (f) For purposes of computing taxes imposed under this part,
6 as provided in subdivision (b):

7 (1) An “S” corporation shall compute its deductions for
8 amortization and depreciation in accordance with the provisions
9 of Part 10 (commencing with Section 17001) of Division 2.

10 (2) Section 465 of the Internal Revenue Code, relating to
11 limitation of deductions to the amount at risk, shall be applied in
12 the same manner as in the case of an individual.

13 (3) (A) Section 469 of the Internal Revenue Code, relating to
14 limitations on passive activity losses and credits, shall be applied
15 in the same manner as in the case of an individual. For purposes
16 of the tax imposed under Section 23151 or 23501, as modified by
17 this section, material participation shall be determined in
18 accordance with Section 469(h) of the Internal Revenue Code,
19 relating to certain closely held “C” corporations and personal
20 service corporations.

21 (B) For purposes of this paragraph, the “adjusted gross
22 income” of the “S” corporation shall be equal to its “net income,”
23 as determined under Section 24341 with the modifications
24 required by this subdivision, except that no deduction shall be
25 allowed for contributions allowed by Section 24357.

26 (4) The exclusion provided under Section 18152.5 may not be
27 allowed to an “S” corporation.

28 (5) The deduction for bad debts under paragraph (2) of
29 subdivision (a) of Section 24348 may not be allowed to an “S”
30 corporation.

31 (g) (1) The provisions of Section 1363(d) of the Internal
32 Revenue Code, relating to recapture of LIFO benefits, shall be
33 modified for purposes of this part to refer to Section 19101 in
34 lieu of Section 6601 of the Internal Revenue Code.

35 (2) For purposes of Section 19023, relating to the definition of
36 “estimated tax,” and Section 19142, relating to an addition to tax
37 for underpayment of estimated tax, the tax imposed pursuant to
38 this subdivision is not a tax imposed by this part.

39 SEC. 7. This act provides for a tax levy within the meaning of
40 Article IV of the Constitution and shall go into immediate effect.

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